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SUBJECT: HKG ASSUMES WATCH OVER AIG'S LARGE LOCAL SUBSIDIARY

¶1. Summary: Sharp declines in locally listed Mainland banking and insurance stocks drove the Hang Seng Index (HSI) down 3.6 percent on September 17, while HKG authorities intensified their oversight of AIG's very large local operating subsidiary, AIA. Local media reported that the HKG's Office of the Commissioner of Insurance instructed AIA to seek the Commissioner's approval, prior to transferring material assets or capital to its parent company or related entities. Hong Kong's Chief Executive and other senior government officials sought to calm nervous AIA policy holders, while editorials on September 17 in two large Chinese language daily newspapers urged the HKG to take extraordinary measures, if necessary, to protect AIA's financial strength. Market participants in Hong Kong remain unsure whether AIG still seeks funding from its global operating subsidiaries, following the USG's recent extension of credit to AIG and its assumption of control over the company. End summary.

#### Hang Seng Continues Sharp Decline

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¶2. The Hang Seng Index (HSI) opened 390 points higher, reflecting the market's initial positive response toward the USG's decision to provide AIG with a significant credit line, in exchange for majority ownership of the company. Nervous investors in Hong Kong soon began selling, however, and the HSI was further impacted by sharp declines in locally listed Mainland banking and insurance stocks. The HSI closed down 3.6 percent at 17,637, its lowest trading point of the day. The HIBOR overnight loan rate, as quoted by Hang Seng Bank at 1624 HRS local time, stood at 3.0 percent -- a 50 basis point decline from the previous day's rate, but still high by recent standards.

#### AIG's Operations in Hong Kong and Macau

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¶3. AIA, a wholly-owned subsidiary of AIG, is a key insurance company in both Hong Kong and Macau. Local Chinese press reported on September 17 that AIA accounts for 25 percent of the life insurance business in Hong Kong, and one-third of the total in Macau. According to the Ming Pao and Apple Daily newspapers, AIA has 8,700 employees in Hong Kong, with two million customers paying USD 1.7 billion (HKD 13 billion) of annual premiums. Meanwhile, Macau Daily reported on September 17 that AIA has 1,000 agents in Macau and approximately 115,000 customers paying USD 100 million (MOP 780 million) of annual premiums. In response to AIG-related developments in the United States, AIA issued a short press release on September 16 that emphasized AIA's solid capital base and good reputation. An unnamed HKG source stated that 1,400 AIA customers canceled their policies on September 16, and HKG Commissioner of Insurance Clement Cheung told local media that his office is closely monitoring the AIG/AIA situation.

#### HKG May Block Financial Transfers by AIA to Parent

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¶4. On September 17, Radio Metro Finance and RTHK radio reported that

the HKG instructed AIA to seek the approval of the Office of the Commissioner of Insurance, before AIA transfers material assets or capital to other entities, including its parent company and sister companies under the AIG umbrella. Hong Kong authorities became concerned by U.S. media reports that AIG will seek to draw on funds from its global subsidiaries, as a means to stabilize AIG's financial situation in the United States. Also on September 17, Commissioner of Insurance Cheung said, "Based on the current accounting statements and related information, AIA has sufficient assets to handle the insurance liabilities of its portfolio in Hong Kong. We will exercise the necessary powers to ensure that policy holders in Hong Kong are protected."

#### HKG Officials Reassure Policy Holders

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15. Financial Secretary John Tsang told local media on September 16 that the HKG has been monitoring the financial problems of AIG and their impact upon AIA in Hong Kong. Tsang said the HKG Office of the Commissioner of Insurance has maintained close contacts with regulatory organizations in the United States, senior management of AIG, and the leadership of AIA in Hong Kong, in an effort to assess the impact of AIG's problems on AIA's operations and financial health. Tsang said, "The insurance authority here has a wide range of statutory powers to protect the interests of policyholders. Hong Kong has a healthy insurance system and should be able to handle the current situation."

16. Meanwhile, Chief Executive Donald Tsang said on September 16 that Hong Kong would maintain a "free economy" and refrain from government intervention, despite the current financial turbulence. Hong Kong Monetary Authority Chief Executive Joseph Yam did not

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directly address the difficulties of AIG/AIA, while meeting with local media on September 17. He stressed the HKG's "strong systems" for supervising the operations and financials of banks, securities firms and insurance companies. Yam said AIG's problems will probably not be resolved by government intervention alone, and he stressed the importance of market-based solutions for the current global financial difficulties.

#### Chinese Language Newspapers Urge "Exceptional Approach"

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17. Editorials on September 17 in two large dailies, Ming Pao and Sing Tao Daily, urged the HKG to take extraordinary measures to protect the interests of AIA policyholders. Ming Pao's editorial suggested the government should freeze AIA's assets, if necessary, to prevent its assets or financial reserves from being shifted to AIG in the United States. Sin Tao Daily recommended that the HKG "show its courage" and adopt an "exceptional approach to handle the crisis." Market participants remained unsure about whether AIG still needed substantial funding from its operating subsidiaries, following the USG's decision to extend a US\$ 85 billion line of credit to AIG and take over majority ownership of the firm.

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